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2 United States Bankruptcy Judge
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June 20, 2007

MARK L. HATCHER
CLERK U.S. BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON
AT TACOMA

DEPUTY

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8 **UNITED STATES BANKRUPTCY COURT**
WESTERN DISTRICT OF WASHINGTON AT TACOMA

9 In re:

10 CARL VINCENT MASON and DONNA
11 MARY MASON,

12 Debtors.

13 WASHOUGAL DEVELOPMENT CORP., a
14 Washington Corporation, and JACK C.D.
LEE,

15 Plaintiffs,

16 v.

17 CARL VINCENT MASON and DONNA
18 MARY MASON,

19 Defendants.

Case No. 06-40672

Adversary No. 06-4145

MEMORANDUM DECISION

NOT FOR PUBLICATION

20 Trial in this matter was held on June 6, 2007. In accordance with the adversary
21 complaint, Washougal Development Corp. and Jack C.D. Lee (Plaintiffs) seek to have the
22 debt owed to them by Carl Vincent Mason and Donna Mary Mason (Defendants) declared
23 nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A) and (B), (a)(4), and (a)(6). At the
24 commencement of the trial, the Court denied without prejudice the Defendants' motion to
25 amend their answer to assert a counterclaim. The Defendants also asserted that the

1 doctrines of res judicata and/or collateral estoppel applied to this proceeding. The Court
2 concludes that neither claim nor issue preclusion apply by virtue of the earlier arbitration
3 decision, as the Defendants failed to establish that the arbitration hearing adjudicated issues,
4 other than the amount of damages, raised by the Plaintiffs in their complaint before this Court.

5 There has been no evidence provided indicating that Donna Mason participated in the
6 alleged fraudulent acts; accordingly, she is entitled to a directed verdict dismissing all claims
7 against her.

8
9 Prior to the commencement of trial, the Plaintiff requested that the Court deem as
10 admitted the Admissions contained in the Plaintiffs' First Discovery Requests to Defendants.
11 No request was made by Defendants' counsel to withdraw the Admissions; accordingly,
12 pursuant to Fed. R. Bankr. P. 7036, the Admissions contained in Plaintiffs' Exhibit P-18 are
13 deemed admitted.

14 Based on the evidence, testimony and arguments presented at trial, the Court's
15 findings of fact and conclusions of law are as follows:

16 **FINDINGS OF FACT**

17
18 The Plaintiffs and Carl Vincent Mason (Defendant) were engaged in the business of
19 real estate development and financing. They commenced doing business together in 2001,
20 through a limited liability company, WMDC, LLC (WMDC), and for several years engaged in a
21 substantial number of joint ventures concerning the purchase, sale and development of real
22 estate. Plaintiff Washougal Development Corporation and Defendant, through his wholly
23 owned MDC-I, LLC (MDC-I), participated equally as members of WMDC. The managers of
24 WMDC were both Plaintiff Jack C.D. Lee (Lee) and the Defendant. There is no indication in
25 the record before this Court that Donna Mason was involved in any transaction with the

1 Plaintiffs. On June 9, 2004, the parties agreed to two loans to MDC-I from WMDC (Loans),
2 evidenced in the form of two promissory notes (Notes) in the amounts of \$270,000 and
3 \$92,112.79. The Defendant executed the Notes as President of Madevco, Inc. (Madevco),
4 another of Defendant's wholly owned entities whose license had previously expired in
5 November, 2003. From the Notes it appears that Madevco was to provide collateral for the
6 Loans within 30 days.

7
8 Despite Plaintiffs' demands for collateral, security was not provided by the Defendant.
9 The required interest only Note payments were never made, and the Notes went immediately
10 into default. Subsequently, the Plaintiffs brought an action in Clark County Superior Court to
11 recover their monetary damage and for dissolution of WMDC. The Defendants
12 counterclaimed. On Defendants' motion, the case was referred to arbitration, and WMDC was
13 dissolved by an Arbitration Award dated November 9, 2005. The Arbitrator also awarded
14 Plaintiffs \$510,933.24 against the Defendants (Judgment), which was affirmed on appeal.
15 The Defendants filed the underlying Chapter 7 bankruptcy case on April 7, 2006. This
16 Adversary Proceeding was timely filed seeking a judgment declaring the Judgment
17 nondischargeable pursuant to 11 U.S.C. §523(a)(2)(A) and (B), (4), and (6).

18 **CONCLUSIONS OF LAW**

19
20 Creditors alleging nondischargeability under 11 U.S.C. § 523 have the burden of proof
21 of each element by preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 287-
22 288, 111 S. Ct. 654, 659-660 (1991).

23 **11 U.S.C. § 523(a)(2)(A)**

24 To establish nondischargeability under 11 U.S.C. § 523(a)(2)(A), a creditor must
25 demonstrate by a preponderance of the evidence each of the following five elements:

1 “(1) misrepresentation, fraudulent omission, or deceptive conduct by the debtor;
2 (2) knowledge of the falsity or deceptiveness of his statement or conduct; (3) an intent to
3 deceive; (4) justifiable reliance by the creditor on the debtor's statement or conduct; and
4 (5) damage to the creditor proximately caused by its reliance on the debtor's statement or
5 conduct.” Turtle Rock Meadows Homeowners Ass’n v. Slyman (In re Slyman), 234 F.3d
6 1081, 1085 (9th Cir. 2000) (citing American Express Travel Related Servs. Co. v. Hashemi (In
7 re Hashemi), 104 F.3d 1122, 1125 (9th Cir. 1996); Citibank (South Dakota), N.A. v. Eashai (In
8 re Eashai), 87 F.3d 1082, 1086 (9th Cir.1996)). A creditor need only justifiably rely on
9 representations by a defendant. Field v. Mans, 516 U.S. 59, 74-5, 116 S. Ct. 437, 446 (1995).

11 Considering the evidence presented at trial, including the Admissions, the Loans were
12 made to one corporation controlled by the Defendant, but the Notes were signed by a different
13 corporation controlled by the Defendant, whose license was suspended at that time. The
14 evidence and Admissions further establish that as of the date of the Loans, the Defendant
15 was aware MDC-1 and Madevco did not have the present ability to repay or collateralize the
16 Loans. The failure to repay the Notes gave rise to a breach of contract and the substantial
17 judgment rendered by the Arbitrator in favor of the Plaintiffs.

18 The evidence presented by Exhibit P-13, however, acknowledges that the Plaintiffs
19 were not looking only to the assets of the Defendant’s companies for payment of the Notes,
20 and as presented in Exhibits P-1 and P-2, the Notes did not require that the proceeds be used
21 for any particular purpose, or that the collateralization or payment of the Notes be made by
22 MDC-I. The Plaintiffs were also aware that the Defendant intermittently moved money around
23 his several corporations as needed. (Exhibit P-13). The Defendant’s testimony, supported by
24 Exhibits P-13 and P-14, further indicates that the Defendant did attempt to provide security in
25

1 the middle of July, 2004, when the parties discussed a 22-unit apartment complex as
2 providing a source of collateral, although for it to have worked would have required additional
3 cash or collateral.

4 The Court finds credible the Defendant's testimony that although he did not have the
5 assets in Madevco or MDC-1 currently available to make the Note payments or provide
6 collateral, he had the requisite intent to make the Note payments and provide collateral as
7 required in the future. There has been no evidence presented that the Defendant's other
8 wholly controlled entities were insolvent. Additionally, it has not been established that at the
9 time of the Loans, he would not have personally guaranteed the Notes or pledged what other
10 assets he had available to make the Note payments or provide collateral.
11

12 The Plaintiffs had been doing business with the Defendant for several years and were
13 aware of the Defendant's haphazard manner of conducting business. Nonetheless, Lee
14 completely relied on the Defendant having the money and collateral available within 30 days
15 without doing any investigation of the Defendant's assets or present ability to perform. Even a
16 cursory investigation would have led to the conclusion that Madevco's license had expired.
17 Furthermore, prior to entering into the Loans, the Plaintiff did not require as a condition of the
18 Loans that the assets of the related Defendant's entities be pledged or the personal guarantee
19 of the Defendant, notwithstanding that their business relationship had admittedly began to
20 sour. No inquiry was made as to what collateral would be pledged, who would pledge it, or
21 how the funds would be used. Lee is a sophisticated businessman. The Court concludes that
22 the Plaintiffs' reliance on the Defendant's representations, without doing one iota of due
23 diligence, was not justifiable in these circumstances. Further, the Court concludes that at the
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1 time the Defendant entered into the Loans, he did not have the requisite fraudulent intent or
2 an intent to deceive.

3 **11 U.S.C. § 523(a)(2)(B)**

4 The requirements for a creditor to establish a cause of action under 11 U.S.C.
5 § 523(a)(2)(B) are use the of a written statement that is (1) materially false, (2) representing
6 the debtor's financial condition, (3) upon which the creditor reasonably relied, and (4) that the
7 debtor caused to be made with intent to deceive.

8
9 In the instant case, the Plaintiffs assert that the mere written statement that collateral
10 would be furnished within 30 days satisfies these statutory requirements. The Court
11 concludes, however, that the statement does not concern the Defendant's financial condition,
12 only that collateral for the loans would be obtained within a 30-day period. Furthermore, the
13 Defendant's testimony as to his intent is found to be credible, and the Plaintiff is not found to
14 have reasonably relied on the Defendant's representations as more fully described above.
15 The Court concludes that a preponderance of the evidence fails to establish that the
16 Defendant had an intent to deceive at the time that the Defendant agreed to provide collateral,
17 that a false written representation as to the Defendant's financial condition was made, or that
18 the Plaintiff justifiably relied on representations made by the Defendant. Accordingly, the
19 elements of § 523(a)(2)(B) have not been met.

20
21 **11 U.S.C. § 523(a)(4)**

22 11 U.S.C. § 523(a)(4) excepts from discharge any debt resulting from fraud or
23 defalcation while acting in a fiduciary capacity, embezzlement, or larceny. The broad general
24 definition of a fiduciary—a relationship involving confidence, trust, and good faith—does not
25 apply in the dischargeability context, thereby excluding ordinary commercial relationships from

1 the reach of § 523(a)(4). Lewis v. Short (In re Short), 818 F.2d 693, 695 (9th Cir. 1987).
2 Implied or constructive trusts and trusts ex maleficio also do not create the fiduciary
3 relationship required by § 523(a)(4). Short, 818 F.2d at 695. The required fiduciary
4 relationship must arise from an express or technical trust that was imposed without reference
5 to the wrongdoing that caused the debt. Scott v. Lewis (In re Lewis), 97 F.3d 1182, 1185 (9th
6 Cir. 1996).

7
8 The evidence is clear, and the Plaintiffs did not argue that either a technical or statutory
9 trust was created. Nor did the Plaintiffs cite to a statute that would provide for a technical trust
10 in this situation. The only “fiduciary” language indicated by the Plaintiffs is contained in
11 section 7.6 of the WMDC Limited Liability Company Agreement (Exhibit P-10). This contains
12 general good faith language normally used in commercial business relationships concerning
13 the obligation of both parties toward each other and to WMDC.

14 This language does not create a statutory, technical or express trust. Further, there is
15 no indication that the Defendant breached this duty of good faith, other than possibly failing to
16 provide security for the Loans. It can just as easily be said that the Plaintiffs would have
17 breached this duty by not first investigating whether there was sufficient collateral to secure
18 the Loans, before agreeing to the Loans. Accordingly, the Plaintiffs have not met their burden
19 of proof on this cause of action as required by 11 U.S.C. § 523(a)(4).
20

21 **11 U.S.C. § 523(a)(6)**

22 11 U.S.C. § 523(a)(6) excepts from discharge debts resulting from “willful and malicious
23 injury by the debtor to another entity or to the property of another entity.” What constitutes a
24 “willful and malicious injury” has been clarified by the U.S. Supreme Court to mean a
25 “deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury.”

1 Kawaauhau v. Geiger (In re Geiger), 523 U.S. 57, 61, 118 S. Ct. 974, 977 (1998). The willful
2 injury requirement “is met when it is shown either that the debtor had a subjective motive to
3 inflict the injury *or* that the debtor believed that injury was substantially certain to occur as a
4 result of his conduct.” Petralia v. Jercich (In re Jercich), 238 F.3d 1202, 1208 (9th Cir. 2001).
5 A malicious injury involves “(1) a wrongful act, (2) done intentionally, (3) which necessarily
6 causes injury, and (4) is done without just cause or excuse.” Jercich, 238 F.2d at 1209
7 (quoting In re Bammer, 131 F.3d 788, 791 (9th Cir. 1997) (en banc) (quotations omitted)).
8

9 For purposes of establishing the willful injury requirement, the Plaintiffs do not assert
10 that the Defendant had a subjective motive to inflict injury. Even if the Court agreed that the
11 Plaintiffs met their burden on the willful injury requirement, the Plaintiffs have not
12 demonstrated by a preponderance of the evidence the *malicious* injury requirement. The
13 evidence presented does not establish that the Defendant *intentionally* failed to provide
14 security for the Loans with an intent to cause harm. The Plaintiffs have not met their burden
15 of proof on this cause of action

16 This decision is not meant to condone the conduct of the Defendant. The arbitrator
17 clearly found a breach of contract and awarded a substantial judgment in favor of the
18 Plaintiffs. Such a finding by the arbitrator, however, does not satisfy the more rigorous
19 requirements to establish nondischargeability of the Judgment.
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21 DATED: June 20, 2007

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23 Paul B. Snyder
24 U.S. Bankruptcy Judge
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